No. 12520

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FLO PARKER and ELGIN R. PARKER,

Appellants,

vs.

HARRY C. WESTOVER, Individually and as Collector of Internal Revenue for the Sixth District of California,

Appellee.

Upon Appeal From the District Court of the United States for the Southern District of California,

---

BRIEF FOR THE APPELLEE.

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Appellee.

BRIEF FOR THE APPELLEE.

Opinion Below.

There was no opinion written in this case.

Jurisdiction.

This appeal involves federal income taxes. The taxes in dispute were paid by Elgin R. Parker and Flo Parker for the taxable year 1944 [R. 3, 17] to the Collector of Internal Revenue as follows: Elgin R. Parker paid $31,370.51 on July 14, 1947, and $32,138.50 on September 26, 1947 [R. 26], and Flo Parker paid $31,339.21 on July 14, 1947, and $32,138.50 on September 26, 1947. [R. 11.] Claims for refund were filed by both taxpayers on January 23, 1948 [R. 4, 18], and no action was taken thereon by the Commissioner within six months. The

complaints were filed in the District Court on September 1, 1948. [R. 10, 24.] The suits were, therefore, timely under Section 3772 of the Internal Revenue Code. Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1340. Judgments in these consolidated cases were entered on January 12, 1950. [R. 35-38.] Within sixty days after the entry of judgments or on February 9, 1950, notice of appeal was filed by taxpayers. [R. 40.] Jurisdiction is conferred on this court by 28 U. S. C., Section 1291.

Questions Presented.

The question presented to the jury in this case was whether the taxpayers had entered into a partnership with their four minor children which is to be recognized for federal income tax purposes. The questions raised by taxpayers on this appeal are:

1. Did the District Court err in failing to give taxpayers' requested instructions Nos. 24, A, C and L?

2. Did the District Court err in giving the Collector's requested instruction No. XXXI?

3. Did the District Court err in admitting in evidence a Memorandum in re Incidence of Federal Tax Liability contained in the guardianship files of the Superior Court of the State of California, County of Orange?

4. Did the District Court err in admitting in evidence an instrument designated as an Application for Authority to Compromise Claims contained in the guardianship files in the Superior Court of the State of California, County of Orange?

5. Is the verdict of the jury supported by substantial evidence?

Statutes Involved.

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) [As amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574.] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. (26 U. S. C. 1946 ed., Sec. 181.)

SEC. 182 [as amended by Sec. 150(g), Revenue Act of 1942, c. 619, 56 Stat. 798]. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than

6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b). (26 U. S. C. 1946 ed., Sec. 182.)

Sec. 3797. Definitions.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * *

(2) *Partnership and partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * *

(26 U. S. C. 1946 ed., Sec. 3797.)

Statement.

Taxpayers are husband and wife. They were domiciled in California. Prior to October 31, 1943, they each owned a half interest in the assets of a partnership known as Southern Heater Company. Elgin R. Parker managed the business and received a salary of $12,000 per year. Flo Parker contributed no service to the partnership. At the time the taxpayers had four children of three, six, seven and fourteen years. [R. 47, 59, 142.]

On October 31, 1943, each taxpayer purportedly gave to each child a sixth and one-quarter per cent interest in the business. [R. 47.] Elgin R. Parker was appointed by the Superior Court guardian of the estates of his four children. [R. 47, 51.] Taxpayers and their children (by their father as guardian and with the approval of the Superior Court) signed a partnership agreement on February 25, 1944 [R. 89-91], purportedly effective as of November 1, 1943. [R. 82.] The instrument provided that the parties agreed to become partners for the conduct of the manufacturing business known as the Southern Heater Company [R. 82] and that the parties contributed capital as follows [R. 83]:

Elgin R. Parker	25%
Flo Parker	25%
Flo Dian Parker	12½%
Patricia Lee Parker	12½%
Rowland Tibets Parker	12½%
Arthur Elgin Parker	12½%

The capital of the new purported partnership was identical with the capital of the business prior to October 31, 1943. Elgin R. Parker continued, as before the purported partnership, to operate and manage the business. No services were rendered to the business by Flo Parker or any of the children. [R. 54, 59.] The children had no property other than their purported interest in the business. [R. 54.]

The net income of the business from 1940 through 1946 was as follows [R. 52]:

For the year 1940 the approximate net income was	$ 22,500.00
For the year 1941 the approximate net income was	60,000.00
For the year 1942 the approximate net income was	93,000.00
From January 1, 1943, to October 31, 1943, the net income was	140,160.00
For fiscal year ending November 1, 1944, the net income was	260,576.89
For fiscal year ending November 1, 1945, the net income was	231,137.16
For fiscal year ending November 1, 1946, the net income was	306,050.28

The only withdrawals of income during the taxable year here involved by or on behalf of the children were for the payment of income taxes. [R. 53.] The federal income taxes on their behalf was refundable upon the determination of the Commissioner of Internal Revenue that the entire income from the business was taxable to the parents and the amounts so refundable to the children

were used by Elgin R. Parker and Flo Parker in partial satisfaction of their own individual federal income taxes. [R. 56.]

The only withdrawals by the children in 1945 were $3,750 each which was invested in Government bonds. [R. 53.]

Elgin R. Parker talked to his tax counsel and obtained advice as to the federal income tax consequences of creating a family partnership prior to the formation of the alleged partnership with his children. [R. 53-54, 57, 58. 62, 63.] Elgin R. Parker realized, even before talking to his tax counsel, that if he and his wife gave an interest in the business to their children and formed a family partnership they "should save family income taxes." [R. 58.]

When taxpayers were informed that the purported family partnership arrangement would not be recognized by the Government for income tax purposes, Elgin R. Parker petitioned the Superior Court for use of guardianship funds to pay the deficiency assessed against the parents and for a reallocation of partnership earnings in favor of the parents. [R. 54, 101, 110, 117.] Counsel for the guardian represented to the Superior Court on behalf of the guardian that "the parents furnished all of the capital, do all the work and support the children, so should be taken care of first." [R. 56, 119.] As a further reason for a reallocation of partnership distributable income so the parents would receive a larger percentage than called for in the purported partnership agreement, counsel for the guardian (Mr. Wilson who also represents taxpayers in the present litigation) advised the Superior Court in a memorandum [R. 117-120], filed on behalf of the guardian, that [R. 56, 119] "The father received a

salary of but $12,000, whereas his services were worth at least $52,000 per year * * *."

Taxpayers did not move for directed verdict or in any other manner put before the court below the issue, raised here, that there was no evidence sufficient to support a verdict for the Collector. Taxpayers requested the jury [R. 15] and in effect asked that the case go to the jury. The court instructed the jury on the issue and the law applicable. [R. 140-163.] The jury brought in a verdict for the Collector. [R. 34.] Judgments were entered accordingly. [R. 35-36, 37-38.]

Summary of Argument.

The lower court gave proper and adequate instructions to the jury. In brief the instructions were that the jury must consider all of the evidence in determining whether the parties really and truly intended to create a bona fide and genuine partnership for the conduct of the business. If so taxpayers should prevail. On the other hand if the arrangement was without substance but was a mere sham with no genuine business purpose, the verdict should be for the Collector.

The lower court properly admitted in evidence certain documents, over taxpayers' objection, on the basis that they constituted an admission against interest and/or tended to show that the partnership arrangement was of no substance since the parties' intention was that the arrangement could be changed in the event it was not recognized for federal tax purposes.

While the verdict is amply supported by the evidence (the children contributed nothing but gift capital), taxpayers are not in a legal position to raise the question since they filed no motion below for directed verdict.

ARGUMENT.

I.

The Lower Court Properly Instructed the Jury.

What appears to be the principal question raised by taxpayers in this appeal is whether the lower court properly instructed the jury on the law. (Br. 15.) The lower court in its instructions first advised the jury concerning the nature of the consolidated actions brought by the taxpayers for the recovery of federal income taxes and gave a summary of the undisputed facts as well as the contentions of the parties. [R. 140-142.] The jury was told that Elgin R. Parker and his wife, Flo Parker, were, prior to October 31, 1943, partners in the partnership known as Southern Heater Company and that they owned all of the assets of the business. [R. 142.] On that date taxpayers gave to each of their four children, ages three to fourteen years, a one-eighth interest in the assets of the Southern Heater Company and they and their four children, through their father as guardian of their estate, entered into a written partnership agreement on November 1, 1943, for the conduct of the Southern Heater Company. [R. 143.]

The District Court instructed the jury that Elgin R. Parker and his wife, Flo Parker, had a legal right to reduce or avoid altogether their federal income taxes by any legal means available [R. 145] and that the question was whether they [R. 146]

> really and truly intended that their four minor children would own an interest in the partnership assets and whether they intended that all six of them would join together for the purpose of carrying on the business and sharing in the profits and the losses as partners.

The jury was informed [R. 146] that—

> A partnership is generally said to be created when persons join together their money, goods, labor, or skill, for the purpose of carrying on a trade, profession, or business, and where there is community of interest in the profits and losses.

The District Court made it clear that while nothing in the California or federal law prohibits a family partnership "And there is no reason why Mr. or Mrs. Parker or anyone else should not reduce their taxes by a lawful partnership," the Government may, for federal income tax purposes, inquire as to whether or not the partnership is bona fide or real. [R. 147-148.] The court had, earlier in its instructions, told the jury [R. 144] that—

> The dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid. The one who earns income but gives the right to receive that income to a favorite child has enjoyed the benefit of that income within the meaning of the Internal Revenue laws.

The court then restated the question and gave the law as follows [R. 148, 149-150]:

> And so, members of the jury, we come to the issue that I stated at the beginning: Was this really and truly a business partnership for the year 1944, and during that year did each of these four children through their guardian actually own their share of the partnership earnings?
>
> * * * * * * * *
>
> The transactions between the plaintiffs and their minor children should be carefully scrutinized by you and that if you determine from all the facts that the plaintiffs were able to retain the substance of all the

rights which previously they had in the Southern Heater Company then you must determine that there was no valid partnership between the plaintiffs and their minor children for federal income tax purposes during the year 1944.

And you must determine after considering all of the facts, including the agreement between these plaintiffs and their minor children, the conduct of the parties to that agreement in the execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of the income and the purposes for which it was used, and any other facts throwing light on the true intent of the parties to the agreement whether those parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise known as Southern Heater Company.

After giving general instructions regarding the credibility of witnesses [R. 150-152], direct and indirect evidence [R. 150-151], inferences which the jury was entitled to draw from the evidence [R. 151], burden of proof and other such matters [R. 144], the District Court, in its final sentence before the jury retired, stated [R. 156]: "Now, ladies and gentlemen, it is your problem to determine the intent of the parties in this case as I have instructed you."

Immediately after retiring the jury was, at the request of counsel for taxpayers, called back and was instructed by the court that Elgin R. Parker received a salary of $12,000 before the income for the taxable year of $264,-553.92 was divided 25% to Elgin Parker, 25% to Flo Parker and 12½% to each of the four minor children;

further, that Elgin Parker reported and paid a federal income tax on that salary. The court, in the presence of the jury, asked counsel for taxpayers if his instructions as to those matters covered counsel's point and counsel answered in the affirmative. [R. 158-158A.]

After deliberation the jury sent word to the court that it would like further instructions. [R. 158A-158B.] The jury returned to the court room and the foreman asked the court questions as follows [R. 158B-159]:

> The first question that we would like to know is, according to the federal law what constitutes a partnership and was the gift taken from the business and re-invested in the business considered a contribution to the welfare of the business?
>
> The second question is, we would like to have you read, sir, in the instructions to the jury with regard to family partnerships. Will you please read the instructions to the jury with regard to family partnerships—that part of the instructions that you gave us this morning?

The court answered the jurors' questions, above quoted, as follows [R. 159-161]:

> One instruction that I read this morning was:
>
> "A gift of an interest in a family business, whether absolute or in trust, which makes no real change in the economic situation of the group or in the control or management of the business will not reduce the obligations of the donor to account for and pay income tax on the earnings of the enterprise to the same extent as before the gift was made."
>
> Another one I gave is:
>
> "The issue in this case is whether the partners, Elgin R. Parker and Flo Parker, really and truly in-

tended that their four children would own an interest in the partnership assets and whether they intended that all six of them would join together for the purpose of carrying on the business and sharing in the profits and losses, as partners."

The Supreme Court has defined a partnership as generally said to be created when persons join together their money, goods, labor, or skill, for the purpose of carrying on a trade, profession, or business, and where there is community of interest in the profits and losses.

And I gave you another instruction as follows:

"While partnerships between husbands and wives, or between parents and children, are always open to scrutiny, and to close scrutiny, such partnerships are lawful. There can be legal partnerships between husbands and wives and parents and children under California law."

And another one I gave was:

"The fact that transfers to members of the family group may be mere camouflage does not, however, mean that they invariably are."

And:

"There is no federal law that prohibits a family partnership or a partnership between parents and minor children."

This case was tried before a jury and I tried my best to have the issues settled by the jury without giving any of my own viewpoints. I want to read to you again the instruction that I said represented the real issue, and that is:

"You must determine after considering all of the facts, including the agreement between these plaintiffs and their minor children, the conduct of the parties

> to that agreement in the execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of the income and the purposes for which it was used, and any other facts throwing light on the true intent of the parties to the agreement, whether those parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise known as Southern Heater Company."
>
> In other words, ladies and gentlemen, it is your problem to determine the intent of these people when they set up this partnership. Did they intend to make a sham out of it for the purpose of avoiding income taxes or was it a real, genuine business partnership for the purpose of joining together in the present conduct of the enterprise known as Southern Heater Company?

After giving the above instructions the court again stated the question to the jury as follows [R. 161]: "You have to take all the evidence together and look upon the whole picture and then determine was this a sham or was it a real partnership?"

Counsel for taxpayers excepted to the failure of the court to give taxpayers' requested instruction No. 24. [R. 31.] The court noted the exception and stated [R. 157]:

> I want to call your attention to the fact that everything requested in your instruction 24 was covered by the court's instruction. This instruction is argumentative in form and it emphasizes certain facts in this case which the court has purposely avoided doing.

Counsel for taxpayers also excepted [R. 157] to the court's refusal to give their supplemental requests identified as Numbers A, C and L.

Most of the matters contained in taxpayers' request No. 24 [R. 31] were covered in substance in the instructions given the jury. The court in reviewing the case and giving the undisputed facts advised the jury that the assets of the business given by taxpayers to their children were contributed by the children to the partnership and the court instructed the jury, as above pointed out, that the contribution of capital was a fact to be considered along with all the other evidence in the case in arriving at a decision as to the intention of the parties. [R. 149-150.]

Obviously what taxpayers were seeking by request Numbers 24, A, and perhaps more particularly C [R. 31-32], was to give the jury the impression that taxpayers must prevail if the jury believed that the gifts by taxpayers to their children were unconditional. While the investment of capital, even though it be gift capital, is, as the court pointed out in its instructions, an element to be considered by the jury along with all the other evidence in the case, it is not as a matter of law conclusive and the court properly declined to give the instructions in the language requested by taxpayers. If it were otherwise, the Supreme Court could have easily disposed of the *Lusthaus v. Commissioner,* 327 U. S. 293; *Commissioner v. Tower,* 327 U. S. 280, and *Commisisoner v. Culbertson,* 337 U. S. 733, cases by merely stating that taxpayers should prevail where there was an unconditonal gift and the gift capital contributed to the family partnership. It is submitted that there is no room for argument on the proposition that the contribution of gift capital alone is insufficient to require as a matter of law a verdict for the taxpayer in a case of this kind.

Clearly the lower court was correct in declining to give all of the words contained in taxpayers' requested instruction Number L [R. 32-33], since to do so would have given the jury the impresison, obviously hoped for by taxpayers, that the Superior Court's control over the property of the minors gave substance to the partnership and made the children "true" [R. 32] partners for federal income tax purposes. Taxpayers argue that gift capital contributed by a minor where his father is guardian should be decisive whereas a contribution of gift capital by a child of majority might be nothing more than a circumstance to be considered. A mere statement of that proposition is enough to show that the lower court was right in declining to read the instruction to the jury. It should be noted also in that connection that guardianship funds were, with the approval of the Superior Court, used by both taxpayers to satisfy their individual tax obligations and that further demands in that direction were being made in taxpayers' petitions currently pending in the Superior Court. [R. 54.] With that evidence before it, presented by taxpayers as well as the Collector, the jury might have felt some doubt as to whether the gifts were entirely unconditional. That is another reason why the court was not disposed to give the jury an instruction to the effect that the gifts were unconditional and that the children should be recognized as partners for income tax purposes on that account.

It is submitted that the instructions as a whole gave the correct law of the case and that the lower court bent every

effort to give a fair and impartial statement as to the evidence and the issues. The very language of pertinent portions of the instructions was taken from the opinion in the *Culbertson* case, *supra.* Particular reference in that regard is made to a portion of the instruction, above quoted, to the effect that all of the facts should be considered, including the agreement, the conduct of the parties in the performance of the agreement, their statements, testimony of other persons, the relationship of the parties, their abilities and capital contributions, as well as the actual control of the income. That instruction, the language of which was taken from the *Culbertson* decision, appears twice in the instruction. [R. 149, 160.] The court stated and restated with emphasis, that the question was whether the parties intended to enter into a real genuine business partnership or whether the partnership was a mere sham. [R. 146, 148, 149-150, 156, 160, 161.] It is noteworthy that taxpayers have made no contention that the court's manner of giving the instructions was in anywise prejudicial to their case. No such contention could have been made. The court gave no special emphasis in delivery to any particular portion of the instructions. Nothing said by the court to the jury or in its presence gave any indication whatsoever as to how the court would have decided the factual issue. The court repeatedly told the jury not to gain the impression from anything the court said or did that the court thought that the verdict should go one way or the other and that the jury was the sole judge of the facts.

II.

The Lower Court Properly Gave the Collector's Request for Instruction No. XXXI to the Jury.

The Collector's requested instruction No. XXXI [R. 33] is as follows:

> You are instructed that common understanding and experience are the touchstones for the interpretation of the revenue laws. The dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid. The one who earns income but gives the right to receive that income to a favorite child has enjoyed the benefit of that income within the meaning of the Internal Revenue Laws.

There appears to be no necessity of extending this brief by a discussion of the authorities which also clearly support the instruction. (*Helvering v. Horst*, 311 U. S. 112; *Lucas v. Earle*, 281 U. S. 111; *Lusthaus v. Commissioner, supra; Commissioner v. Tower, supra; Commissioner v. Culbertson, supra.*) Reference is also made to Section 22(a) of the Internal Revenue Code, *supra*, defining gross income.

III.

The Lower Court Properly Admitted in Evidence an Instrument Contained in the State Court Guardianship Files Designated as a Memorandum in re Incidence of Federal Income Tax Liability on 1944 Partnership Income.

Taxpayer, Elgin R. Parker, testified that he received a salary from the partnership business of $12,000 for the fiscal year ending October 31, 1944, which is the taxable year in suit and that such salary represented reasonable compensation for his services rendered to the business during that period. [R. 49, 51.] Mr. Parker further testified that he and his wife filed claims against the guardianship estate in the amount of $111,151.89. [R. 54.] Taxpayers introduced in evidence an Application for Authority to Compromise Claims [R. 101, Pltf. Ex. 16] and introduced as a part of the same exhibit an Order for Authority to Compromise Claims [R. 105], signed by the Judge of the Superior Court [R. 107] April 25, 1947, in which Elgin R. Parker and Flo Parker were authorized to use refunds of federal income taxes, payable to the minors, in partial satisfaction of a deficiency of federal income taxes assessed against Elgin R. Parker and Flo Parker. [R. 106-107.] Upon said application the court further ordered [R. 106]—

> That in the event Elgin R. Parker and Flo Parker eventually lose their litigation with the Commissioner of Internal Revenue with respect to the incidence of the tax on the income of this partnership that Elgin

> R. Parker and Flo Parker be permitted to keep and retain said refunds in at least part settlement of their claims against the guardianship estate on account of income taxes, and that the claims of Elgin R. Parker and Flo Parker be further considered, and if necessary, adjudicated.

In support of their petitions or applications for authority to use guardianship funds for the benefit of taxpayers herein, the guardian's attorney, Melvin D. Wilson, filed a memorandum on behalf of the guardian [R. 117-120], in which it was urged that the estates of the children should bear all of the additional income tax burden of their parents resulting from a non-recognition for federal income tax purposes of the family partnership. The memorandum contains certain reasons upon which the guardian petitioned that the children should bear the deficiencies in federal income taxes assessed against their parents. Included therein is the following [R. 119]:

> The father received a salary of but $12,000, whereas his services were worth at least $52,000 per year. If a full and fair salary of $52,000 per year had been paid the father, a result more comparable to that shown in situation C would have obtained.

Taxpayers, in their brief (p. 35), say that the lower court erred in admitting the memorandum in evidence for the reason that—

> This memorandum was filed with the Superior Court by appellants' counsel without appellants'

> knowledge and without any information or advice from them. It contained a statement by the counsel that Elgin R. Parker's services were worth $52,000.00 per year. This was an expression of opinion by a person not shown to be qualified as having a worth-while opinion on this point and furthermore it was a statement of opinion and not a statement of fact. It was made without the appellants' knowledge and without any information or advice having been given by them to their counsel on such point.

Mr. Parker testified, as stated in taxpayers' brief (p. 34), that his attorney, Mr. Wilson, was authorized to file papers on his behalf in the guardianship matter; further, that after Mr. Wilson had filed the memorandum in question, counsel sent him a copy of the memorandum [R. 58] and that he, Mr. Parker, did not go to the Superior Court and disaffirm the statement in the memorandum that his services were worth to the partnership $52,000 a year rather than $12,000 a year, being the amount paid. It is submitted that under the circumstances and the evidence in this case the memorandum was admissible as an admission against interest.

Conclusion.

The District Court gave proper and adequate instructions to the jury and the court ruled correctly on the admissibility of evidence. Taxpayers cannot raise the question as to whether the verdict finds support in evidence. Moreover, the verdict is amply supported by the evidence. The judgments of the District Court should be affirmed.

Respectfully submitted,

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